



Office of Inspector General  
Legal Services Corporation

Inspector General  
Jeffrey E. Schanz

3333 K Street, NW, 3rd Floor  
Washington, DC 20007-3558  
202.295.1660 (p) 202.337.6616 (f)  
www.oig.lsc.gov

**FRAUD ALERT  
15-02**

To: Executive Directors

From: Jeffrey E. Schanz  
Inspector General 

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Subject: Conflict of Interest Policy

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The purpose of this Fraud Alert is to inform you of prior investigations that uncovered conflicts of interest resulting in issues of fraud, waste and abuse. We hope this information assists you in developing a conflict of interest policy in order to protect against charges of impropriety involving key employees in your program.

Based on work completed by the Office of Inspector General (OIG) for the Legal Services Corporation (LSC), we discovered instances of grantee Executive Directors (ED) and Fiscal Officers (FO) entering into related party transactions with members of their families, friends and associates. These transactions created conflicts of interest and allowed employees of the grantee to unjustly receive financial benefits using LSC funds.

A related party transaction occurs when an employee participates in a matter in which a related party has a financial or material interest. A related party can be any person who is a friend, immediate family or household member, fiancé, or significant other, or who is in a dating relationship with a program employee. Prior business relationships or former client/employee relationships can also qualify individuals as related parties.

Below are three examples of investigations completed by the OIG that led to criminal prosecutions of grantee employees involving related party transactions:

- FO entered into a contract with an associate to purchase office supplies for the grantee, of which 90 percent were never received. This less than arm's length

business arrangement allowed the FO and the associate to steal over \$1.25 million of grant funds.

- ED of a sub-grantee entered into a secret contract with her husband for janitorial services at an inflated cost. Using a fictitious business name, the sub-grantee paid 66 percent more for janitorial services than the local going rate. In total, ED issued 48 checks made payable to her husband's fictitious business totaling nearly \$47,000.
- FO entered into a contract with her fiancé resulting in payments totaling \$5,000 for work that was not performed.

Many LSC programs have recognized the need to adopt a conflict of interest policy to cover job situations or work matters that may give rise to questions about the impartiality, independence, or objectivity of their employees due to the potential for nepotism, bias, or favoritism. In addition to related party transactions, other types of activities that could create conflicts for employees include acceptance of gifts, holding stock in a company that conducts business with the grantee, outside parties paying for employee travel, outside employment (including teaching, speaking or writing), participating in restricted political activities, and evaluating and awarding contracts, grants or service agreements.

While different in some aspects, the conflict of interest policies adopted by many legal aid programs and non-profits uniformly impose a duty on employees to disclose the existence of any direct or indirect financial or material interest they may have in a work matter due to a personal or business relationship. These policies also serve to educate employees who may not be familiar with the concept and expectations of a conflict of interest policy and provide guidance to management and the Board for handling actual or potential conflict of interest situations.

These conflict of interest policies also commonly share the following characteristics:

- Employees must disclose, in writing, the material facts of any potential conflicts of interest that they may have with the program in any matter, typically to management or the Board, in order to determine whether they must recuse themselves from the matter or will be permitted to initiate or continue their involvement with the matter.
- Employees and Board members each receive a copy of the conflict of interest policy and must annually acknowledge receipt of, an understanding of, and adherence to the policy. Management provides appropriate training.
- Avenues to report conflicts of interest regarding other employees are established that permit submission of confidential complaints.

- Policies and procedures (such as a whistleblower protection policy) are established to prevent retaliation against individuals who make reports in good faith.

Conflicts of interests are undesirable because they potentially place the private interests of others ahead of the non-profit's obligations to its charitable purposes and public interest. Impact to a grantee by not adopting a conflict of interest policy includes the possibility of losing its tax exempt status and funding, incurring fines, and attracting intense public scrutiny and negative publicity due to the occurrence of fraud.

The OIG brings this subject to your attention to help ensure that if an actual or perceived conflict of interest occurs at your program, a responsive process is in place for the affected individual to promptly advise the program of all material facts regarding their situation.

For reference, the Internal Revenue Service (IRS), Form 1023, Appendix A, Sample Conflict of Interest Policy, <http://www.irs.gov/instructions/i1023/ar03.html>, provides a model conflict of interest policy for Board members. LSC's own policy covers all employees.

[http://sceweb.lsc.gov/sites/default/files/eweb/pdfs/LSC Code of Conduct FINAL%282%29.pdf](http://sceweb.lsc.gov/sites/default/files/eweb/pdfs/LSC_Code_of_Conduct_FINAL%282%29.pdf). The OIG recommends that you develop a policy that covers all program employees. Additionally, your program is required to annually answer questions regarding a conflict of interest policy in Part VI, Section B, of the IRS Form 990. <http://www.irs.gov/uac/Current-Form-990-Series-Forms-and-Instructions>.

Any suspected violations of your conflict of interest policy should be reported to your Board and the OIG. The OIG can be reached at 1(800) 678-8868.

I hope you find this Fraud Alert useful. Should you have any questions, please do not hesitate to contact Daniel O'Rourke, Assistant Inspector General for Investigations, at (202) 295-1651, or by email at [dorourke@oig.lsc.gov](mailto:dorourke@oig.lsc.gov).